MINUTES

Financial Accounting Standards Board

To: Board Members

From: Project Team (Beckendorff x 229)
(Chesney x 3447)

Subject: Minutes of the July 11, 2007 Conceptual Framework Board Meeting **Date:** July 11, 2007

cc: Leisenring, Bielstein, Golden, MacDonald, Allen, Polley, Glotzer, Klimek, Lott, Gabriele, Sutay, Project Team, FASB Intranet, Upton, Hickey, Crook, Lian, Hague, Villmann, Willis, GASB: Reese, Patton

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Topic: Phase B: Elements and Recognition

Phase C: Measurement

Phase D: Reporting Entity

Basis for Discussion: Memorandum Nos. 59-62

Length of Discussion: 9:00 a.m. to 11:00 a.m.

Attendance:

Board members present: Herz, Batavick, Crooch, Seidman, Smith, and Young

Board members by phone: Linsmeier

IASB members present: Leisenring

Staff in charge of topic: Bossio, Hague, McBeth
Other staff at Board table: L.T. Johnson, Bielstein, Bement, Beckendorff, and Chesney

Summary of Decisions Reached:

At the July 11, 2007 meeting, the Board discussed matters related to three phases of the conceptual framework project: elements and recognition, measurement, and reporting entity.

With regard to the Elements and Recognition phase, the Board discussed whether the staff should temporarily set aside further consideration of the remaining issues surrounding the working definitions of an asset and a liability and focus its limited resources on considering other cross-cutting issues in this phase. Issues deal with unit of account, recognition, and derecognition. The Board decided that, in order to better understand the remaining asset and liability definition issues and how they relate to other cross-cutting issues, the staff should:

1. Apply the working definition of an asset to various types of assets,
2. Document the issues that arise from the application of that definition, and
3. Determine whether (and how) resolution of those issues could benefit from working on unit of account, recognition, derecognition, measurement.

With regard to the Measurement phase, the Board discussed the following:

1. The Board discussed measurement concepts, principles, and terms intended to help the Boards and staff identify and understand differences in measurement basis candidates.

2. The Board discussed the use of three criteria derived from the concepts and principles of measurement (real attribute, present attribute, and observable attribute) to evaluate measurement basis candidates.

With regard to the Reporting Entity phase, the Board decided that the forthcoming initial Discussion Paper/Preliminary Views (DP/PV) to be issued on the reporting entity concept should be exposed for public comment for a period of 120 days.

Objective of Meeting:

The objective of the meeting was to discuss matters related to three phases of the conceptual framework project: elements and recognition, measurement, and reporting entity. The objective of the meeting was met.

Matters Discussed and Decisions Reached:

ELEMENTS AND RECOGNITION

1. Ian Hague led the discussion regarding elements and recognition. Mr. Hague first addressed the results of the asset definition consultations. He stated that the staff had consulted with both Boards' advisory committees, various national standards setters, selected academics, and other selected individuals on the working definition of an asset that the Boards have been developing. Mr. Hague noted that, based on the feedback from the consultations, further clarification and explanation of some of the proposals in the working definition seem necessary. He stated that, while the consultations revealed that there are different views as to how the definition might better be expressed, there was general agreement that the proposed working definition of an asset captures the right ideas and includes improvements compared to the existing IASB and FASB definitions.
2. Mr. Hague stated that the staff thinks that much of the work remaining on the asset and liability definitions relates to clearer expression of the proposals. This includes settling on the final words to be used, including the order of those words in the definition, as well as striking the appropriate balance between the definition and the amplifying text. He stated that, before such work is undertaken, the staff thinks it would be useful to consider other issues in Phase B. Mr. Hague stated that the staff recommends setting aside, temporarily, direct consideration of the remaining asset and liability issues and beginning consideration of the cross-cutting issues dealing with unit of account, recognition, and derecognition. He noted that, ideally, the staff would continue work on both aspects of the elements and recognition phase; however, limited resources would require a sequencing decision to be made.

3. Mr. Leisenring stated that he did not support setting aside issues regarding the asset and liability definitions. He stated that he believes there is significant confusion about the working definition of an asset, especially in regard to rights and resources. Mr. Leisenring stated that he agreed the working definition was an overall improvement, but he was not sure whether, at a basic level, the Boards had a common understanding of what is meant by the terms used in the working definition or existing definitions. He stated that there is not a common understanding among members as to what is meant by right, resource, control, or enforceability. Mr. Leisenring stated that, before the Boards accept or dismiss terms to be used in the asset definition, they should find out whether they have a common understanding of what those terms actually mean. He suggested that the best way to do this would be to apply the definitions of an asset to various arrangements and see if Board members can agree on how the various terms in the definitions apply.
4. Mr. Linsmeier stated that it was difficult to provide a suggestion on this topic because the staff had not clearly identified why setting aside direct consideration of definitional issues to consider unit of account, recognition, and derecognition was preferable to moving forward with the asset definition. He stated that the staff had not clearly identified which unit of account, recognition, or derecognition issues have come up or why the definitions can not be further refined until those issues have been resolved. Based on the evidence provided, Mr. Linsmeier stated that he could not make the judgment that unit of account problems are impeding the resolution of issues arising from the asset definition consultations, nor could he conclude that addressing unit of account problems might expedite the resolution of those definition issues.
5. Mr. Linsmeier stated that he believed the most progress could be made by applying the current definition to a list of asset candidates and systematically identifying present economic resources and rights. Based on the issues arising from that application, Mr. Linsmeier stated that the working definition could be refined and the plan for moving forward with the definition could be implemented. He stated that this exercise would help identify the issues

(such as unit of account, recognition, and derecognition) that require further investigation within the context of the asset definition. Mr. Herz stated that measurement issues might also arise in the context of the asset definition.

6. Ms. Bielstein noted that the Board seemed to be looking at two options:
    a. Temporarily set aside direct consideration of the remaining asset and liability issues and begin consideration of the cross-cutting issues dealing with unit of account, recognition, and derecognition.
    b. Continue to move forward with the asset definition by systematically applying the working definition to a list of asset candidates, analyzing the issues that arise in that application, and prioritizing those issues that are pivotal to applying the definition.
7. The Board suggested that the staff commence with the latter option.
8. Mr. Crooch stated that he would be willing to move forward with the unit of account, recognition, and derecognition issues in order to help resolve those definitional issues that are not progressing.
9. Ms. Seidman stated she would be concerned if the definition issues were set aside because definition concepts (such as rights and obligations) are being used as the basis underlying several standards setting projects. She referenced the revenue recognition and leasing projects and emphasized that there was an immediate need to address the issues associated with executory contracts. Ms. Seidman stated that whichever alternative was chosen, issues regarding executory contracts should be a priority (irrespective of whether they are definitional or unit of account issues).
10. Mr. Batavick stated that, because the elements and recognition phase deals with the “building blocks” of the framework, he was concerned with the limited resources being dedicated to the phase.

MEASUREMENT

Background

11. In Milestone I, the Boards agreed to a set of measurement basis candidates and definitions of those candidates. The purpose of standardizing measurement basis terminology was to improve communication and understanding among Board members, staff, and constituents throughout the

measurement phase of the CF project. The staff thinks that a similar effort with respect to measurement concepts is as important, if not more so. Both within and outside the discipline of accounting, terms such as *measurement*, *estimation*, *calculation*, *allocation*, and *forecast* have been used interchangeably. The result has been imprecision in communication and confusion of the concepts behind the terms.

12. Although accounting standards frequently use the terms *measure* and *measurement,* the staff is not aware of any standard that defines measurement. Some accounting standard setters have provided definitions in their conceptual frameworks. However, the standard setters' definitions of measurement are not discriminating enough for our purposes. Because the existing methods for determining financial statement amounts include calculation, estimation, allocation, and forecasting, those definitions do not provide a means for distinguishing between measurement and those other activities. Furthermore, those definitions do not provide a means for evaluating the measurement basis candidates because they do not discriminate among the candidates or their variations in any way.

Measurement Theories

13. There are three basic theories of measurement, all of which are products of either the physical or social sciences:

    a. *Classical Theory:* assumes that an objective reality exists that can be observed. According to classical theory, measurement is the process of mapping an observable attribute[1] of a physical object onto the imaginary world of mathematics using a rule. Stated another way, measurement is the process of representing quantitative attributes of physical things in terms of numbers.

    b. *Representational Theory:* still assumes an objective reality, but that reality may be qualitative rather than physical and thus may not be directly observable. In representational measurement, social scientists look for observable attributes, often behaviors, which are assumed to be related to the unobservable attribute of interest. A model is then developed that mathematically relates the observable attribute(s) to the unobservable attribute. Even though the attribute of interest cannot be

[1] The terms *property* and *dimension* also are used in classical theory. The term *basis,* as used in the CF project, is intended to have the same meaning as these other terms.

observed, it is assumed to exist because relationships between the observable attribute(s) can be explained in terms of the unobservable attribute.

c. *Operational Theory:* does not assume any objective reality, observable or unobservable. In the operational theory, the operation that is called measurement is more important than what is being measured. If the result of the operation is considered useful (if it can be used to make predictions, for instance), then it does not matter whether what is being measured can be observed, or whether it even exists.

Measurement Levels

14. A better understanding of the consequences of adopting one of the above theories of measurement as opposed to the others is possible if those theories are related to the different levels of measurement:

    a. *Ratio Measurement*: the highest level of measurement in Stevens' scheme. The feature that distinguishes ratio measurements from those at lower levels is found in the term *ratio.* Numbers that result from ratio measurements can be used to create meaningful ratios. Stated differently, it is meaningful to apply the mathematical operations of multiplication and division to such numbers. For a measurement scale to be a ratio scale, it must have an absolute zero value (in contrast to a relative zero value such as that found in Celsius and Fahrenheit temperature scales). Otherwise, multiplication and division of measurement results cannot faithfully represent the physical reality.

    b. *Interval Measurement*: Measurements in this level are so named because the intervals between units on interval measurement scales are equal. This is also true of ratio scales; however, interval scales do not have an absolute zero value. Therefore, addition and subtraction of interval measurements may be meaningful, but multiplication and division cannot be. Temperature measurements using the Centigrade and Fahrenheit scales are common examples of interval measurements. For measurements using those scales, it is meaningful to say that a measurement of 10º is five degrees warmer than a measurement of 5º, but it is not true that 10º is twice as warm as 5º.

    c. *Ordinal Measurement*: The distinguishing feature of ordinal measurements is that they can be used to indicate the rank order (1^{st}, 2^{nd}, 3^{rd}, and so forth) of things with respect to the property of those things that is measured. Thus, comparisons can be made between two objects to the effect that one object is greater than or less than another object in terms of that property. However, higher order

mathematical operations on ordinal measurements, such as addition and subtraction, have no meaning.

d. *Nominal Measurement*: the lowest level in Stevens' measurement scheme. As with ordinal measurements, nominal measurements may be given in terms of either numbers or words. The numbers or words of nominal measurements are, in effect, names or labels for the objects being measured. There are no measurement scales in nominal measurement. The names or labels given to the objects simply result in sorting those objects into various categories. The only comparisons that can be made using nominal measurements are those of equality and inequality, but those comparisons do not have any quantitative meaning. In the context of nominal measurement, equality and inequality mean only "of the same category" or "not of the same category."

15. The staff thinks that the classical theory is the appropriate one to use for two reasons. The first reason is that assets and liabilities have economic attributes of interest to accounting that are measurable in the sense that term is used in the classical theory. The second reason is that the level of measurement that is most appropriate for measuring assets and liabilities is ratio measurement, which is most closely associated with the classical theory.

Measurement Principles

16. There are several principles derived from measurement theory that may be useful in understanding the nature of measurement and in evaluating the measurement basis candidates in this project. By *principle*, the staff means a basic assumption or premise. The principles are in no particular order, nor are they intended to form a complete list. Others may be added in future discussions if the need arises. These principles have been selected to clarify the nature of measurement in the sense the staff has recommended above, namely, classical measurement.

    a. *Single Attribute*: It is not possible to measure an object or event itself. Only an attribute, relation, dimension, aspect, etc., of an object or event can be measured.
    b. *Present Timeframe*: Measurement takes place only in the present. Thus, future dimensions or relations of things cannot be measured, only forecast. Past dimensions or relations can be measured in the present if the necessary observations have been made in the past and all that remains to be done in the present is to compare observations to

each other, compare an observation to a scale, or use the observation in a calculation.

c. *Observability:* Only that which can be observed can be measured. This principle, of course, only applies to measurement in the classical sense.
d. *Inexactness:* Measurement is by nature generally inexact. Absolute precision and exactness exist only in the discipline of mathematics.
e. *Variability:* Measurement is variable with respect to the conditions in which it is made.
f. *Invariance:* A property required of good measurements is that the resulting comparison between objects should be the same, or invariant, irrespective of other factors.

Terms Related to Measurement

17. Although there are many terms relating to measurement, the staff thinks that those that are the most basic and that commonly are confused with measurement should be focused on initially. Each term is discussed in terms of a process. However, in the case of *estimation*, *calculation, allocation,* and *measurement,* the same term is used for both the process and the outcome of the process. Thus, the result of the process of estimation may be called an estimation (as well as an estimate), and the result of the process of calculation is a calculation.

    a. *Estimation:* Estimation is used as a synonym for at least three processes:

        i. As *Approximation*: Estimation is often used in conjunction with both measurement and calculation. In both instances, estimation has the same meaning, namely the process of making a rough approximation. An implication of this meaning in either case is that something more precise could be done, but is not done for some practical reason.
        ii. As *Measurement:* Estimation is used also as a substitute for measurement. Because there is always some degree of error in measurement, some scientists think it is inappropriate to refer to the result of any measurement process as a measurement. Instead, they prefer to call the result an estimate. The staff thinks that distinction is unnecessary and obscures the meaning of measurement that this paper has tried to clarify.
        iii. As *Modeling*: estimation is used in situations where measurement is either not possible or not feasible. Such situations may occur when the measurement attribute is not observable, when no measurement method has been developed, or when measurement is prohibitively costly. A

theoretical model then may be used to quantify what cannot be measured.

b. *Calculation:* the process of applying mathematical operations to numbers

c. *Allocation:* the process of distributing something according to some rule

d. *Prediction:* The process of making a statement about an unobserved object or event. There are three classes of prediction:

   i. *Retrodiction*: Making statements about the past state of objects that have not been observed, or about past events that have not been observed
   ii. *Prediction*: Forming statements about the present state of objects that are not being observed, or about present events that are not being observed
   iii. *Forecasting*: statements about the future state of objects or about future events

Discussion

18. Kevin McBeth led the discussion regarding measurement concepts and principles. Mr. McBeth stated that the goal of Milestone II is to evaluate the measurement basis candidates established in Milestone I in sufficient depth so that the Boards will be able to make reasoned conclusions in Milestone III. He noted that there are many different criteria that could be used to evaluate those measurement basis candidates and stated that, throughout Milestone II, the staff would use various sets of criteria to evaluate the measurement basis candidates.
19. Mr. McBeth stated that, today, the Board would discuss using a set of three criteria (real, present, and observable) derived from the measurement principles to evaluate the measurement basis candidates. Mr. McBeth clarified that not all measurement principles were being used as evaluative criteria because some measurement principles (such as inexactness, variability, and invariance) were too broad to be discriminating. He noted that measurement principles, such as inexactness apply to all measurements, and, therefore, would not be useful evaluative criteria.

20. Mr. Bossio noted that, because the three criteria being discussed today were derived from the measurement concepts and principles developed in a recent memo, they might be more difficult for the Board to evaluate. He added that the Board would be evaluating the measurement basis candidates based on the qualitative characteristics at a later point in Milestone II.
21. Mr. McBeth clarified that the staff is not seeking definite decisions throughout Milestone II, but rather guidance from the Board, especially regarding usefulness of the attributes criteria carried forward into the second memo (real, present, observable).
22. Mr. Batavick questioned whether or not measurement basis candidates would be eliminated if they did not meet the three criteria (real, present, or observable). Mr. Leisenring stated that those measurement basis candidates that do not meet the narrow definition of measurement should be eliminated from further consideration. Mr. McBeth clarified that the Boards decided at the joint meeting in April not to eliminate a measurement basis candidate based on any one specific concept or idea addressed in Milestone II. He stated that it was also important to keep in mind that, even though the focus is on financial statements right now, the overall objective is financial reporting, and candidates that may not be useful in financial statements may in fact be useful in financial reporting.
23. Mr. Smith asked what the purpose of the measurement phase was. He stated that he would like to know what the end result was supposed to be, how it would be useful, and when to expect it. Ms. Bielstein stated that the end result would be a chapter in the conceptual framework that would help the Board in setting standards that deal with “assigning amounts” to items, whether that assignment is a measurement, estimation, allocation, etc. She noted that the staff is trying to make sure that the right steps are taken to obtain that end result. Mr. McBeth added that detailed, higher level analysis was essential to reaching that goal for several reasons. First, he stated that this topic is not included in the current framework. Second, he stated that this is a very contentious issue (which is why it never made it in the current

framework). He noted that previous efforts had tried less deliberate approaches and were not successful as a result.

24. Mr. McBeth stated that this detailed analysis would probably not be included in the actual framework chapter, but it would act as a basis for conclusions. He stated that the high-level information on measurement theories, levels, principles, and terms would (and should) come up often in Milestone 2 as it would be necessary to make sure there is a common understanding regarding ideas that everyone already **thinks** they understand, but might not. He stated that "measurement" is one of those ideas and noted that current practice does not properly distinguish measurement from other methods of assigning amounts.
25. Mr. Smith stated that he believed the staff was over-analyzing the issue and making it more complicated than it needed to be. Ms. Seidman seemed to agree. She stated that she found the detailed, high-level measurement information interesting, but she did not believe that it would be productive for the Board to further discuss those details. Rather, she stated that it would be more productive to evaluate the nine measurement basis candidates against the qualitative characteristics. Ms. Seidman stated that what we call the "assignment of amounts" is much less important than actually being able to understand why a method of assigning amounts is preferable. She stated that she hoped the end result would provide a more "macro" view of measurement.
26. Mr. Herz stated that he believed this "deeper realm of thought" provided distinctions that could be useful in helping the Board make decisions. He noted that this phase should deal with all methods of "putting numbers into financial reports" and that the "measurement phase" label could be misleading now that a common, narrow view of measurement has been established.
27. Mr. Linsmeier stated that he believed it was necessary to "over-complicate" things at this point. He stated that moving to a more "macro" view too quickly would cause the Board to leave behind some very important definitional differences and measurement concepts provided in the first memo. For

example, he stated, it will be important for the Board to keep in mind the ratio scale notion associated with the classical form of measurement when deciding what measurement attributes should be considered for different line items. He explained:

> The staff has noted that the preferred measurement theory for accounting purposes is the classical theory of measurement, partially because of the classical theory of measurement's association with the ratio scale of measurement. The ratio scale of measurement requires an absolute zero and allows one to compare and contrast numbers very well so that various calculations such as addition, subtraction, multiplication, and division can be performed. A problem will arise in achieving that ratio scale if different measurement attributes are allowed in different line items within the financial statements. If the circumstance arises where a calculation has a fair value measurement in the numerator and a different measurement basis in the denominator, the resulting number will not be relevant.

28. Mr. Linsmeier stated that the first memo was very successful in explaining ideas to think about and terms to keep in mind. However, he stated that he was concerned that narrowing down the list of measurement principles to only three criteria would cause the Board to lose the appropriate context in making evaluations as the project moves forward. Mr. Linsmeier stated that he was not sure if the attributes carried forward (real, present, and observable) were comprehensive enough to allow the Board to contemplate how to assign dollar amounts in financial reports.
29. Mr. Linsmeier also stated that he was concerned that focusing on only certain measurement attributes would result in concentrating on the classical measurement definition as the preferred accounting model and would not consider some of the other factors that may be necessary when considering other methods of assigning dollar amounts (estimation, allocation, etc.). He added that constituents could interpret this approach as pre-ordaining a Board desire to go to a current value measurement model. He noted that the three attributes carried forward in the second memo (real, present, and observable) are observable attributes in the current time period, but principles such as inexactness and variability (attributes associated with cost-benefit notions) are left behind.

REPORTING ENTITY

30. Ron Bossio led the discussion regarding the reporting entity Preliminary Views document comment period. He stated that the staff recommends the comment period be 120 days rather than 180 days in order to move the project along before the IASB meeting in September.
31. The Board agreed that the forthcoming DP/PV on the concept of a reporting entity should be exposed for a comment period of 120 days. Most Board members indicated that they would support a 180 day comment period if the IASB decided it was necessary. Mr. Linsmeier explicitly stated that he would not support a 180 day comment because it would hinder the project's progress.

Follow-up Items:

None

General Announcements:

None